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RUEATRS/DEPT OF TREASURY WASHDC

INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS

RUCPDOC/DEPT OF COMMERCE WASHDC

RUEHKO/AMEMBASSY TOKYO 1659

RUEHBJ/AMEMBASSY BEIJING 4813

RUEHBY/AMEMBASSY CANBERRA 2166

RUEHUL/AMEMBASSY SEOUL 4466

RUEAIIA/CIA WASHDC

UNCLAS SECTION 01 OF 04 JAKARTA 000515

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DEPT FOR EAP/MTS AND EB/IFD/OMA

TREASURY FOR IA-SETH SEARLS

SINGAPORE FOR SUSAN BAKER

COMMERCE FOR 4430-BERLINGUETTE

DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR FINEMAN

DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [PGOV](#) [ID](#)

SUBJECT: INDONESIA - ECONOMIC AND FINANCIAL HIGHLIGHTS JANUARY - FEBRUARY 2007

**¶1.** Summary. Indonesia's inflation in February came as expected at 7.4% on a year-on-year (YoY) basis, after an unexpectedly large jump in January. Bank Indonesia (BI) has maintained its reference interest rate at 8% for the past four months. Indonesia's economy grew at 6.3% in 2007, the fastest pace in a decade. Fitch Ratings raised Indonesia's foreign and domestic currency debt ratings to two levels below investment grade, citing the Government of Indonesia's (GOI) continuous structural reform agenda and strong current account position. During January-February, the GOI raised \$2 billion from global dollar-denominated bonds, and Rp 12.9 trillion (\$1.4 billion) from rupiah-denominated bonds. The GOI closed the State Asset Management Company (PPA) on February 27. The Capital Market and Non-Bank Financial Institution Supervision Agency (Bapepam-LK) and the Securities and Exchange Organization of Iran (SEO) signed an agreement to enhance bilateral cooperation. The Indonesian Corruption Eradication Commission (KPK) named three central bank officials as suspects in a bribery case. President Yudhoyono (SBY) sent two names to the Parliament as candidates for BI Governor for the next term, neither of them BI insiders. This cable uses an exchange rate of 9,051 per dollar. End summary.

Unexpected Inflation Jump

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**¶2.** The Central Bureau of Statistics (BPS) recorded a 1.8% (MoM) rise in the consumer price index (CPI) in January, bringing annual inflation to 7.4%, the highest rate since September 2006, when the rate stood at 14.6%. BI claimed that the sharp increase was a one-time shock, due to a rise in commodity prices. However, BI subsequently increased its inflation forecast for 2008 to 6.0-6.5%, up from around 5%. Coordinating Minister for Economic Affairs Boediono stated that he is optimistic inflation will remain within its 4-6% forecast this year. BI Governor Burhanuddin Abdullah and Finance Minister Sri Mulyani announced that the GOI will focus on inflation control. Mulyani noted, "The President wants all food-related costs reduced." She added that the GOI has already reduced import duties and taxes to help bring price increases under control. The GOI announced a large policy package designed to stabilize food prices on February 4 (ref B).

**¶3.** The CPI rose by 0.7% in February or 7.4% on a yearly basis, in line with analysts' expectations after the January big jump. Analysts note that rising global commodity prices and disruptions to

the transport of goods caused by floods and natural disasters in some parts of the country continue to put pressure to food prices in Indonesia.

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Table 1: Consumer Price Inflation Components  
January - February 2008

Component	January		February	
	MoM	YoY	MoM	YoY
Foodstuffs	2.77	11.35	1.59	12.18
Prepared food,				
Beverages, tobacco	2.02	7.62	0.88	7.86
Housing, water, electric, fuel	1.80	6.01	-0.01	5.15
Clothing	2.31	11.21	0.76	11.43
Health	0.72	4.51	1.56	5.46
Education, recreation/sports	0.01	8.73	0.04	8.52
Transportation, communication and financial services	0.24	1.39	0.02	1.39
Total	1.77	7.36	0.65	7.40
Core Inflation (1)	1.52	7.11	0.76	7.33

Note:

(1) Core inflation is a measure of inflation which excludes certain items that face volatile price movements i.e. energy, food products.

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Source: Central Bureau of Statistics (BPS)

Interest Rate Unchanged at 8.0%

¶4. Although aggressive U.S. rate cuts created some space for easing, BI left its key interest rate unchanged for the fourth month at 8.0% on March 6, as policymakers were wary of mounting price pressures. The move was in line with analysts' expectations, following the unexpectedly sharp rise in inflation in January.

¶5. On January 9, the Indonesian Deposit Insurance Agency (LPS) cut its rupiah and dollar maximum bank deposits rates by 25 basis points on expectations of lower inflation this year. The new rates stand at 8% for rupiah deposits and 4.25% for dollar deposits. Commercial banks closely watch LPS' decisions on maximum guaranteed bank deposit rates, which directly influence their profit levels.

Fastest Growth in Ten Years

¶6. On February 15, BPS announced that Indonesia's gross domestic product (GDP) expanded 6.32% in 2007, the fastest pace in ten years, as declining borrowing costs encouraged companies to invest and consumers to spend. YoY growth for Q4 2007 was 6.25%, despite floods, other natural disasters, world oil price hikes and the US subprime mortgage crisis. Construction, transportation and communications sectors contributed significantly to overall growth. Record coal prices and surging income from sales of cocoa and cooking oil have raised wages in those sectors, encouraging spending on cars, motorbikes and mobile phones. Private consumption, which represents about 70% of the economy, rose 5.6% in Q4, the fastest pace in almost four years.

Fitch Upgrades Ratings for Indonesia

¶7. On February 14, Fitch Ratings raised Indonesia's foreign and domestic currency debt ratings one notch from BBB- to BB, the

highest level since the 1997 Asian financial crisis. BB is two levels below investment grade and one grade higher than Moody's Indonesia rating, which is Ba3. The Fitch rating is on par with Standard & Poor's, which rates the foreign currency debt at BB-/B and domestic debt at BB+/B. Fitch cited the government's structural reform agenda and strong non-oil and gas exports as reasons for the upgrade. "The GOI's efforts to tackle corruption, bureaucratic and regulatory hindrances to investments intensified in 2007 and were complemented by key investment legislation as well as an economic policy package specifically aimed at addressing main investor concerns," says Ai Ling Ngiam, Director in Fitch's Sovereign Ratings team. "Positive economic growth and balance of payments (BOP) implications had already become evident in 2007, enabling Indonesia to enter the current period of tightened global credit conditions and weaker external demand on a firmer footing," added Ms. Ngiam. The outlook is stable according to the agency's assessment.

¶8. The ratings hike surprised some analysts given the uncertainty surrounding global economic trends. Fauzi Ichsan, a respected economist with Standard Chartered, noted, "The upgrade would have been more realistic and understandable in the second half of the year when the global economic situation clarifies." However, Fitch believes Indonesia will ride out a US slowdown better than its regional peers because Indonesia's exports to the US account for less than 5% of GDP, compared with more than 20% for Singapore, Malaysia and Hong Kong. Only about 10% of Indonesia's exports to China are components for US-bound products, compared with more than 50% for many other Asian nations. The Wall Street Journal also pointed to Indonesian assets as a useful hedge against global concerns, noting that a global slowdown will affect some areas of the economy, resource stocks and producers of non-traded goods should remain strong. David Fergusson, head of Indonesian research at Citigroup Global Markets also opined in a recent report that Indonesia is relatively immune to external shocks. Finance Minister Sri Mulyani said the upgrade, "confirms our achievements to strengthen our fiscal structure."

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Bond Auctions Well Subscribed

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¶9. Indonesian bonds have attracted strong interest from foreign and domestic investors because of their relatively high yields, particularly following the recent cut in US interest rates. On January 10, the GOI offered global bonds worth \$2 billion, attracting almost 200 orders from global institutional investor. The offering consisted of \$1 billion worth of 10-year bonds with a coupon rate of 6.9%, and \$1 billion worth of 30-year bonds with a coupon rate of 7.75%. The GOI priced the global bonds to yield 3.1% and 3.3% points over comparable US Treasuries, respectively. The price was higher than 1.9% points over US debt for its 2007 30-year bond sale and reflects the extent to which Asian markets have come under pressure.

¶10. On January 22, the GOI raised Rp 2.3 trillion (\$254.1 million) from an auction of 15-year and 30-year treasury bonds, priced to yield 10.55% and 10.8% respectively. The issuance follows an auction of mid-term bonds launched on January 29 that raised a total of Rp 3.7 trillion (\$408.8 million). The mid-term bonds consisted of two- and five-year zero coupon bonds, priced to yield 8.25% and 9.4% respectively.

¶11. At its February 12 auction, the GOI raised a total of Rp 1.05 trillion (\$116 million), selling 5-year bonds at a 9.2% yield and 10-year bonds at an average yield of 10.1%. On February 19, the GOI raised another Rp 5.85 trillion (\$646.3 million) from auctioning five- and ten-year zero coupon bonds priced to yield 9.55% and 8.6% respectively. Without elaborating on the maturity of the debt to be issued, a MOF official said the ministry expects to issue treasury bills within the next two months and short-term debt regularly every month. The government aims to raise Rp 91.6 trillion (\$10.1 billion) from net bond issuances in 2008, the finance ministry said.

GOI Asset Sales above Target

**¶12.** Scheduled to sunset on February 27, 2009, the State Asset Management Company (PPA) will cease operations September 2008 in order to settle accounts by the final deadline. PPA is a successor organization to the Indonesia Bank Restructuring Agency which handled distressed assets after the financial crisis. PPA generated Rp 1.57 trillion (\$173.5 million) from asset sales in 2007, a figure slightly higher than its target of Rp 1.5 trillion (\$165.7 million).

According to PPA President Director Mohammad Syahrial, PPA posted a pretax profit of Rp 71 billion (\$7.8 million) last year, well over its target of Rp 12.9 billion (1.4 million). Proceeds of the asset divestments fund the state budget.

Capital Market Supervisory Agency  
Signs Sharia Cooperation Deal with Iran

**¶13.** On January 28, the Capital Market and Non-Bank Financial Institution Supervision Agency (Bapepam-LK) and the Securities and Exchange Organization of Iran (SEO) signed an agreement to enhance bilateral cooperation, particularly in enhancing Indonesia's shariah stock market. The total market capitalization of Iran's shariah market is \$50 billion. Besides cooperating in the shariah sector, the two countries plan to exchange training, information and expertise in order to develop institutional capacity and better regulate their capital markets.

Central Bank Scandals

**¶14.** At its January 25 plenary meeting, the Indonesian Corruption Eradication Commission (KPK) named BI governor Burhanuddin Abdullah along with BI Legal Affairs Director Oey Hoey Tiong and BI Surabaya office Director Rusli Simanjuntak as suspects in a bribery case. Indonesian authorities detained Tiong and Simanjuntak in mid-February and banned 15 other BI officials from international travel until further notice, according to media reports. The KPK alleges that BI officials paid Rp 31 billion (\$3.4 million) in bribes to legislators and law enforcement officials in 2003 and

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**¶12004.** According to the KPK, BI disbursed Rp 96.25 billion or \$10.5 million (\$7.5 million from the Indonesian Banking Development Foundation and \$3 million from the BI budget) to lawmakers to resolve BI officials legal problems related to the misuse of Bank Indonesia Liquidity Assistance (BLBI) funds and to pass banking legislation. BLBI refers to the emergency liquidity credits extended by Bank Indonesia to commercial banks during the 1997-98 financial crisis.

Candidates for New BI Governor

**¶15.** On February 15, President Yudhoyono (SBY) sent two nominations for BI Governor to the Parliament, neither of whom is a BI insider. The candidates are Bank Mandiri's Chief Executive Agus Martowardojo and the deputy director of state asset company PT Perusahaan Pengelola Aset (PPA) Raden Pardede. A committee in Parliament rejected the candidates in mid-March and the recommendation will go to Plenary. The current five-year term of Governor Burhanuddin Abdullah ends by May 17. SBY may have to choose another candidate if the Plenary decides against the nominees.

Table 2: Selected Economic, Financial, and Trade Statistics, November 2007 - February 2008

	Nov	Dec	Jan	Feb
CPI Inflation (YoY)	6.71	6.59	7.36	7.40
CPI Inflation (MoM)	0.18	1.10	1.77	0.65
Rp/USD Exch. rate(1)	9,376	9,419	9,347	9,051

30-day SBI rate (1)	8.25	8.00	8.00	8.00
Foreign Res. (\$ bn)(1)	54.9	56.9	56.0	57.1
JSX Composite Index(1)	2,688	2,746	2,627	2,722
Exports (\$ billion)	9.8	10.9	11.1	
Percent change (YoY)	10.0	13.1	33.2	
Imports (\$ billion)	7.5	6.8	7.6	
Percent change (YoY)	20.4	21.8	43.9	
Trade Balance	2.3	4.1	3.5	

Source: Bank Indonesia, BPS, JSX

(1) End of period

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